

“Should Cost” Analysis

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Society of Cost Estimating Glossary

SHOULD COST

- A concept of contract Pricing that employs an integrated team of Government Procurement cost and price analysts, contract administration, auditors, and Engineering representatives to conduct a coordinated, indepth Cost review and Evaluation of a program at the contractor's plant. Its purpose is to identify uneconomical or inefficient practices in the contractor's management and operations, to quantify the findings in terms of their impact on cost, and to develop a realistic price objective for Negotiations or for the program that reflects the results of the shouldcost effort.

SHOULD COST ESTIMATE

- An Estimate of contract price which reflects reasonably achievable contractor Economy and Efficiency, and is developed by a Should Cost analysis at a contractor's plant.

Should Cost Estimate

- Addresses costs of specific contracts, not a full life-cycle costs.
- Purpose:
 - Identify uneconomical or inefficient practices in contractor's management or operation
 - Quantify findings in terms of cost
 - Develop a realistic price objective for negotiation or for the program that reflects the should cost effort

Definition: Taken from the National Estimating Society Dictionary, Fall 1986

Should Cost Estimate, continued

- Typically employ two teams
 - Production
 - Overhead
- Teams work together to evaluate and challenge a contractor's existing methods, materials, facilities, work force, management, and operating procedures
- Based on contractor's proposal
- Results can be used to negotiate new Forward pricing Agreements

Should Cost Review –FAR

15.407-4 -- Should-Cost Review.

(a) General.

- (1) Should-cost reviews are a specialized form of cost analysis. Should-cost reviews differ from traditional evaluation methods because they do not assume that a contractor's historical costs reflect efficient and economical operation. Instead, these reviews evaluate the economy and efficiency of the contractor's existing work force, methods, materials, equipment, real property, operating systems, and management. These reviews are accomplished by a multi-functional team of Government contracting, contract administration, pricing, audit, and engineering representatives. The objective of should-cost reviews is to promote both short and long-range improvements in the contractor's economy and efficiency in order to reduce the cost of performance of Government contracts. In addition, by providing rationale for any recommendations and quantifying their impact on cost, the Government will be better able to develop realistic objectives for negotiation.
- (2) There are two types of should-cost reviews -- program should-cost review (see paragraph (b) of this subsection) and overhead should-cost review (see paragraph (c) of this subsection). These should-cost reviews may be performed together or independently. The scope of a should-cost review can range from a large-scale review examining the contractor's entire operation (including plant-wide overhead and selected major subcontractors) to a small-scale tailored review examining specific portions of a contractor's operation.

Should Cost Review –FAR

(b) Program should-cost review.

- (1) A program should-cost review is used to evaluate significant elements of direct costs, such as material and labor, and associated indirect costs, usually associated with the production of major systems. When a program should-cost review is conducted relative to a contractor proposal, a separate audit report on the proposal is required.
- (2) A program should-cost review should be considered, particularly in the case of a major system acquisition (see part 34), when --
 - (i) Some initial production has already taken place;
 - (ii) The contract will be awarded on a sole source basis;
 - (iii) There are future year production requirements for substantial quantities of like items;
 - (iv) The items being acquired have a history of increasing costs;
 - (v) The work is sufficiently defined to permit an effective analysis and major changes are unlikely;
 - (vi) Sufficient time is available to plan and adequately conduct the should-cost review; and
 - (vii) Personnel with the required skills are available or can be assigned for the duration of the should-cost review.
- (3) The contracting officer should decide which elements of the contractor's operation have the greatest potential for cost savings and assign the available personnel resources accordingly. The expertise of on-site Government personnel should be used, when appropriate. While the particular elements to be analyzed are a function of the contract work task, elements such as manufacturing, pricing and accounting, management and organization, and subcontract and vendor management are normally reviewed in a should-cost review.
- (4) In acquisitions for which a program should-cost review is conducted, a separate program should-cost review team report, prepared in accordance with agency procedures, is required. The contracting officer shall consider the findings and recommendations contained in the program should-cost review team report when negotiating the contract price. After completing the negotiation, the contracting officer shall provide the ACO a report of any identified uneconomical or inefficient practices, together with a report of correction or disposition agreements reached with the contractor. The contracting officer shall establish a follow-up plan to monitor the correction of the uneconomical or inefficient practices.
- (5) When a program should-cost review is planned, the contracting officer should state this fact in the acquisition plan or acquisition plan updates (see [subpart 7.1](#)) and in the solicitation.

Should Cost Review –FAR

(c) Overhead should-cost review.

- (1) An overhead should-cost review is used to evaluate indirect costs, such as fringe benefits, shipping and receiving, real property and equipment, depreciation, plant maintenance and security, taxes, and general and administrative activities. It is normally used to evaluate and negotiate an FPRA with the contractor. When an overhead should-cost review is conducted, a separate audit report is required.
- (2) The following factors should be considered when selecting contractor sites for overhead should-cost reviews:
 - (i) Dollar amount of Government business.
 - (ii) Level of Government participation.
 - (iii) Level of noncompetitive Government contracts.
 - (iv) Volume of proposal activity.
 - (v) Major system or program.
 - (vi) Corporate reorganizations, mergers, acquisitions, or takeovers.
 - (vii) Other conditions (e.g., changes in accounting systems, management, or business activity).
- (3) The objective of the overhead should-cost review is to evaluate significant indirect cost elements in-depth, and identify and recommend corrective actions regarding inefficient and uneconomical practices. If it is conducted in conjunction with a program should-cost review, a separate overhead should-cost review report is not required. However, the findings and recommendations of the overhead should-cost team or any separate overhead should-cost review report

When to do a Should Cost Estimate

- Some initial production has already taken place
- The contract will be awarded on a sole-source basis
- There are future year production requirements for substantial quantities of like items
- The items being acquired have a history of increasing costs
- The work is sufficiently defined to permit an effective analysis and major changes are unlikely
- Sufficient time is available to plan and conduct the should cost analysis adequately
- Personnel with the required skills are available or can be assigned for the duration of the should cost analysis

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Further Information

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